

Beyond Lending

**How Multilateral Banks Can Help
Developing Countries Manage Volatility**

Guillermo Perry

**Center for Global Development
Washington, D.C.**

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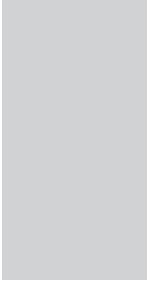
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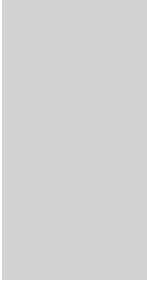
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Preface

We first discussed a draft of this book in a lively and well attended seminar at the Center for Global Development in March 2008. At the time many emerging markets had been doing extremely well and seemed to no longer need multilateral support. It was hard to imagine that a few months later we would be in the middle of the worst economic crisis in the developed world since the Great Depression, a crisis that would end up hitting emerging markets so hard.

Although many—if not most—developing countries were indeed doing better than ever and had ample access to private markets, Guillermo Perry insisted in the first draft of this book manuscript that they remained vulnerable to such external shocks as commodity price declines, capital flow reversals, and natural disasters. He argued that the resulting risks constituted a menace to their future development and not only required that the countries take preventive action but also indicated that multilateral institutions should help enhance their access to international insurance and hedging instruments, both existing and new. In particular, he argued that although the effects of the U.S. financial crisis had so far seemed contained, it would have been “disingenuous to assume full decoupling and to believe that the probability of liquidity shocks in developing countries as a group [was] relegated to economic history.” We were unable to “rule out any possibility of a global recession and/or of a global financial meltdown that would severely hit many developing countries.”

The draft proposals elicited diverging reactions. Much to their credit, Robert B. Zoellick, the president of the World Bank, Daniel M. Zelikow, representing President Luis Alberto Moreno of the Inter-American Development Bank, and vice presidents from other regional development banks not only recognized that such risks to development were real but made clear their view that the excess capital held by multilateral development banks should be used to help developing countries gain access to enhanced insurance and hedging market products. They explained that various initiatives were already moving in this direction in their respective institutions.

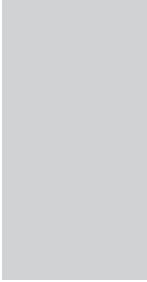
Other participants, however, remained skeptical of such roles for the multilateral development banks and, influenced by the financial exuberance of the times, tended to minimize the risks. They argued instead that fast-growing private markets themselves were developing new instruments that could deal with the risks to developing countries and that multilateral development banks should hold back and concentrate on the poorest and least developed of their clients.

The unfolding global economic downturn of late 2008 and early 2009 is an unfortunate reminder that dealing with external risks indeed remains a major development challenge. We now face a different type of institutional risk: the crisis has brought many clients back to development banks, and demand for their traditional, plain-vanilla loans is booming. The multilateral development banks as of this writing are seeing their previous excess capital being fully exploited, and they are proposing new capitalizations. In this situation it is likely that they will go back to business as usual and cease to innovate in the development of new risk-management products. What was an emerging healthy trend of rethinking the development banks' long-term roles and modernizing their instruments and procedures may fall prey again, as has happened in the past, to complacency and bureaucratic inertia.

As a think tank dedicated to the cause of development, we at the Center for Global Development put a premium on calling to task the global development community and warning against such a risk. We hope that this publication will help alert the heads of multilaterals and others pushing for modernization to the dangers of falling into a kind of intellectual moral hazard that the renewed demand for traditional lending represents.

The preparation and publication of this book was made possible by the generous support for our work on global development policy from the William and Flora Hewlett Foundation and by institutional support from the Bill & Melinda Gates Foundation, the Chair of our Board Edward W. Scott Jr., and other friends of CGD.

Nancy Birdsall
President
Center for Global Development



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